Internal Revenue Service

memorandum

CC:TL-N-4944-88
Brl:RTBailey

date: JUN 7 1988

to: District Counsel, Oklahoma City SW:OKL

from: Director, Tax Litigation Division CC:TL

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subject: [redacted]
SSN: [redacted]

This is in response to your request for technical advice dated March 24, 1988, concerning the above taxpayer.

ISSUE

Whether the land is held in trust by the United States Government as required by the first test set forth in Rev. Rul. 67-284 under the circumstances of this case. 0061-0000.

CONCLUSION

We concur in your opinion that the first test set forth in Rev. Rul. 67-284 for determining whether income received by an Indian is exempt from federal income tax has been met in this case. Although the land is not expressly held in trust as required under the statute, a trust relationship exists under the Act of March 1, 1901, 31 Stat. 861, with respect to alienation of the land allotted to members of the Five Civilized Tribes which imposes a high fiduciary duty on the United States. In addition, the statutory language of the Act contains provisions restricting alienability by the Indian alottees and provides for immunity from tax similar in tenor to the provisions of the General Allotment Act. Further, the reasons underlying enactment of the Act governing the land at issue is similar to those found to exist under the General Allotment Act in Capoeman. Thus, in light of the fact that as a general rule courts interpret statutes conferring tax exemptions for Indians in the Indians' favor, the hazards of litigation in pursuing this case are formidable. We therefore believe that the royalty income received by the taxpayer in this case should be recognized as exempt from federal income tax.

FACTS

The instant case concerns whether oil and gas royalty income received in taxable years [redacted], [redacted] and [redacted] by the taxpayer under a lease executed with an oil company for the exploration rights to his property is excludable from federal income taxation pursuant to Rev. Rul. 67-284. As indicated in your formal advisory opinion to the Chief, Examination Division, Oklahoma City, attached to your request for technical advice, the taxpayer included the oil and gas royalties in gross income in the years at issue. By amended return the taxpayer has filed timely claims for refund for each year seeking to exclude the royalty payments from gross income on the theory that they are exempt from federal taxation. The land involved in this case is restricted Indian land. The taxpayer, [redacted], is [redacted] Cherokee-Creek Indian and [redacted], a [redacted] blood member of the Creek tribe which is part of the Five Civilized Tribes.

ANALYSIS

In Rev. Rul. 67-284, 1967-2 C.B. 55, considered in Indian Income--Taxation of Proposed Omnibus Revenue Ruling, G.C.M. 33342, I-2063 (September 30, 1966), the Service comprehensively set forth its position as to the federal income tax treatment of Indian-related income. According to the ruling, income derived directly by a noncompetent Indian from allotted and restricted land held under acts or treaties containing an exemption provision similar to the General Allotment Act is not subject to the federal income tax. The first test required to be met under Rev. Rul. 67-284 before the Service will recognize the exempt status of income received by an enrolled member of an Indian tribe is that the land in question be held in trust by the United States Government.1/

Unlike an allotment under the General Allotment Act, (see discussion at page 4), the instant allottee owns the land in fee. Act of March 1, 1901, 31 Stat. 861; Oklahoma Tax Commission v. United States, 319 U.S. 598 (1943). [redacted] grandmother, [redacted], was allotted the land as a homestead pursuant to the Act of March 1, 1901. The homestead deed conveying title of the land to [redacted] was filed of record on [redacted]. Pursuant to the Act of January 27, 1933, 47 Stat. 777, as amended, this land continues to be designated as exempt from taxation and restricted as to alienation as long as it is owned by an Indian heir or devisee of one-half or more blood. See [redacted].

1/ Section 5 of the General Allotment Act of 1887 provides that the United States will hold the allotted land in trust for the Indian. (24 Stat. 388, 25 U.S.C.A. § 331 et seq., 349)

Accordingly, in Walker v. United States, 633 F. Supp. 258 (E.D. Okl. 1987), the court determined that the land allotted to members of the Five Civilized Tribes may not be sold or leased for oil and gas exploration except after proper state court approval.

In Walker, the court stated:

> Congress reserved to itself the right to declare certain lands belonging to the Five Civilized Tribes to be inalienable unless a state court, within the jurisdiction in which the land is located, gives its approval of the sale. Indians are represented at the state court by attorneys under the auspices of the Department of Interior. These provisions for attorneys to appear on behalf of Indians having interests in restricted lands are set forth in the Act of May 27, 1908, ch. 199, Pub. L. 140, 35 Stat. 312 (1908), the Act of January 27, 1933, ch. 23, Pub.L. 323, 47 Stat. 777 (1933); and the Act of August 4, 1947, ch. 458, Pub.L. 336, 61 Stat. 731 (1947).

In determining whether in carrying out its statutory duties the United States holds a "trust relation with the Indians" the court held that the federal government was liable for gross negligence for breach of duty to represent [redacted] regarding alienation of his interest in restricted Indian land as to the proposed oil and gas lease. Walker, supra at 266.

Further, in Seminole Nation v. United States, 316 U.S. 286 (1942), which involved a suit to adjudicate certain claims of the Seminole Nation against the United States growing out of various treaties and acts of Congress similar to those that govern disposition of the land allotted to members of the Five Civilized Tribes the court stated:

> In carrying out its treaty obligations with the Indian tribes, the Government is something more than a mere contracting party. Under a humane and self imposed policy which has found expression in many acts of Congress and numerous decisions of this Court, it has charged itself with moral obligations of the highest responsibility and trust. Its conduct, as disclosed in the acts of those who represent it in dealings with the Indians, should therefore be judged by the most exacting fiduciary standards. 316 U.S. at 297.

It is clear from the above cited cases that the United States Government is charged with a position of trust in representing the Indians that requires the highest fiduciary responsibility. As additional support for our conclusion that a trust relationship exists in the instant case it is noted that the background file for Rev. Rul. 67-284 has documentation which refers to a tax exemption for income derived directly from trust or restricted allotted land. Trust land is defined as land held by the United States in trust for the Indian to whom it has been allotted. Restricted land is land which has been allotted to an Indian subject to restrictions against alienation or encumbrance. See Memorandum dated November 3, 1965, to Mr. Stone from Mr. Willan, entitled Tax Treatment of Income of Indians. However, there is no documentation in the file indicating why the test was limited to include only land held in trust by the United States Government when Rev. Rul. 67-284 was promugated.

Furthermore, as discussed previously Rev. Rul. 67-284 provides that income derived directly from allotted and restricted Indian land covered not by the General Allotment Act but rather by other acts dealing with a particular tribe would be exempt if the statute or treaty contains an exemption provision with language similar to that of the General Allotment Act.

A comparison of the General Allotment Act to the Act of Congress as amended which governs disposition of the land allotted to members of the Five Civilized Tribes indicates such a similarity.

Section 6 of the General Allotment Act (Codified as amended at 25 USC 349 (1982)) provides that the Secretary of the Interior may, in his discretion, whenever he shall be satisfied that any Indian allottee is competent to manage his or her affairs, cause to be issued to such allottee a patent in fee simple, and thereafter all restrictions as to sale, incumbrance, or taxation of said land shall be removed.

The Act of March 1, 1901, 31 Stat. 861, pertaining to the Creek Nation, and the later ratified Acts, likewise provide that the land allotted to members of the Five Civilized Tribes is inalienable, restricted and nontaxable until further Act of Congress.

We also acknowledge that the underlying purpose of each of these Acts was to protect the Indians from loss to individuals who might take advantage of them. See Oklahoma Tax Commission v. United States, 319 U.S. 598, 604 (in reference to the Act of January 27, 1933. 47 Stat. 777 pertaining to the Indians of the Five Civilized Tribes). Similarly, in Squire v. Capoeman, 351 U.S. 1 (1956), the Supreme Court held that the General Allotment Act exempts noncompetent Indians from capital gains tax on the

timber proceeds from allotted land. In so holding the Court observed that "[t]he purpose of the allotment system was to protect the Indians' interest and to prepare the Indians to take their place as independent qualified members of the modern politic." 351 U.S. at 9.

It seems clear that in enacting the Act pertaining to the alottment of land to the Indians of the Five Civilized Tribes that Congress was motivated by the same purposes which underlay their granting an exemption from tax to individual Indians holding allotted lands under the General Allotment Act. This was the conclusion reached in U.S. v. Hallam, 304 F.2d 620 (10th Cir. 1962), in which the court held that income derived from restricted, allotted Indian lands in the form of rentals, royalties, and proceeds from certain sales, was exempt notwithstanding that the land in question was not covered by the General Allotment Act, but rather by the Act of March 2, 1895, 28 Stat. 876, 907. The Court stated, upon consideration of the provisions of the General Allotment Act and the special statutes involved in this case, that Congress intended that so long as the Indians involved in this case continued in their status as wards of the United States, their allotted land should be treated in the same manner as those of all other Indians encompassed by the General Allotment Act. See also Hayes Big Eagle v. U.S., 300 F.2d 765 (Ct. Cl. 1962), in which the court held that the distribution of tribal mineral headright income to noncompetent Osage Indians, governed by the provisions of the Osage Allotment Act of June 28, 1906, 34 Stat. 539, and not the General Allotment Act, would nevertheless be nontaxable.

In summary, we agree with your determination that the first test set forth in Rev. Rul. 67-284 is met in this case. Further, because the Act as amended that confers a tax exemption to income derived directly from the land in this case is similar in tenor to the Gerneral Allotment Act, we believe that the royalty income received by the taxpayer should be recognized as exempt from federal income tax.

MARLENE GROSS
Director

By: Dan Henry Lee
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